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SUPERIOR COURT
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STATE OF WASHINGTON
THURSTON COUNTY SUPERIOR COURT

MIKE KREIDLER,
INSURANCE COMMISSIONER,

Petitioner,

v.

WESTERN UNITED
LIFE ASSURANCE COMPANY,

Respondent.

NO. 04-02-00406-1

THIRD REPORT OF RECEIVER

COMES NOW, Mike Kreidler, the Insurance Commissioner of the State of Washington and Statutory Receiver of WESTERN UNITED LIFE ASSURANCE COMPANY ("WESTERN UNITED"), James T. Odiorne, Deputy Insurance Commissioner and court-appointed Receiver of WESTERN UNITED, and Wayne C. Metcalf, III, Special Deputy Insurance Commissioner and court-appointed Chief Deputy Receiver of WESTERN UNITED, by and through their attorneys, Rob McKenna, Attorney General, and Christina Gerstung Beusch, Assistant Attorney General, and hereby submit the Third Report of Receiver, pursuant to RCW 48.31.040(5), and state as follows:

1. *Order of Rehabilitation.* On March 2, 2004, this Court entered an Order of Rehabilitation and Appointment of Receiver placing WESTERN UNITED into rehabilitation proceedings pursuant to Chapters 48.31 and 48.99 RCW, and appointing the Statutory Receiver, Receiver and Chief Deputy Receiver (hereinafter collectively "Receiver").

1 2. *Amended Order of Rehabilitation.* On October 22, 2004, this Court entered an
2 Amended Order of Rehabilitation and Appointment of Receiver that replaced the original
3 Order of Rehabilitation and Appointment of Receiver and related back to the original issuance
4 date of March 2, 2004.

5 3. *Accounting to the Court.* RCW 48.31.040(5) and the Amended Order of
6 Rehabilitation require that the Receiver make accountings to the Court not less than
7 semiannually.

8 4. *Financial Report.* Attached hereto as **Exhibit A** is the June 30, 2005 financial
9 statement of WESTERN UNITED. As of June 30, 2005, WESTERN UNITED had capital
10 and surplus, as calculated under Statutory Accounting Principles ("SAP"), in the amount of
11 \$50,929,073. The Insurance Commissioner has adopted regulations promulgating SAP as the
12 accounting framework to be used by insurance companies transacting business in Washington.
13 *See* RCW 48.05.073 and WAC 284.07.050.

14 The 2004 Annual Statement (as of December 31, 2004) filed with the OIC stated that
15 WESTERN UNITED had capital and surplus in the amount of \$63,341,682. The March 31,
16 2005 Quarterly Statement stated that WESTERN UNITED had capital and surplus of
17 \$60,638,475. The June 30, 2005 Quarterly Statement states that WESTERN UNITED has
18 capital and surplus of \$50,929,073, which includes a reduction of \$5,095,859 to restate capital
19 and surplus as previously reported for December 31, 2004. The restatement was necessary for
20 the results of an appraisal of certain properties in Hawaii securing affiliated mortgage loans
21 receivable, the report of which was received and accepted in the second quarter of 2005, but
22 which was dated in 2004. WESTERN UNITED is currently undergoing a regularly scheduled
23 audit by the firm of Amper, Politziner & Mattia, P.C. of Edison, New Jersey for 2004. The
24 deadline for filing the audited financial statement has been extended by the OIC from June 1,
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1 2005 through September 30, 2005, pending the resolution of certain concerns surrounding
2 WESTERN UNITED's affiliate reinsurance agreements (see ¶ 6 below). It is believed that
3 when the audit is complete and the report issued, that the December 31, 2004 capital and
4 surplus will be restated in the amount of \$58,245,823 as a result of the above-stated \$5,095,859
5 restated reduction to the capital and surplus. WESTERN UNITED is also currently reviewing
6 its real estate loan loss reserving methodology and application.
7

8 RCW 48.05.340 sets forth the minimum capital and surplus for authorized insurance
9 companies such as WESTERN UNITED. WESTERN UNITED has met the minimum capital
10 and surplus requirements. In addition, RCW 48.05.430 through .490 require an authorized
11 insurance company to have in total adjusted capital and surplus a sufficient amount as
12 determined by the company's risk-based capital ("RBC") formula. As a result of WESTERN
13 UNITED's RBC score at the end of 2003, the company was placed in RBC supervision status.
14 Based on its RBC score at December 31, 2004, WESTERN UNITED remains in RBC
15 supervision status. Despite ongoing efforts to increase its RBC score through reduction of
16 asset risk exposure primarily through the sale of its owned real estate and the control of
17 mortgage defaults, it is unlikely that WESTERN UNITED will achieve a sufficient RBC score
18 to exit RBC supervision status by the end of 2005.
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21 5. *Retention of Policyholders.* There have been no substantial increases in
22 surrenders. WESTERN UNITED continues to experience surrenders and withdrawals below
23 anticipated levels. For the first 8 months of 2005, withdrawals were 20% and 17% lower
24 respectively when compared to the same period for years 2003 and 2002. As a result, there is
25 currently no liquidity problem at WESTERN UNITED caused by surrenders or withdrawals.
26

1 This has allowed WESTERN UNITED to invest more cash in an effort to maximize
2 investment return.

3 6. *Reinsurance.* WESTERN UNITED is reinsured under reinsurance agreements
4 with Old Standard Life Insurance Company ("Old Standard"), an affiliated entity that was
5 placed into receivership by the Idaho State Department of Insurance on March 2, 2004. As of
6 August 31, 2005, in-force deferred annuity policies with an aggregate account value of
7 \$89,118,325.95 remain reinsured under the agreements. Additionally, as of September 21,
8 2005 WESTERN UNITED is owed \$11,289,433.44 for paid claims and fees under the terms of
9 the reinsurance agreements.
10

11 Subsequent to the filing of the Second Report of Receiver on March 10, 2005 (at which
12 time Old Standard owed WESTERN UNITED \$3,203,990.43), Old Standard satisfied a
13 portion of the amounts then owed under the agreements by transferring to WESTERN
14 UNITED a parcel of real property at Rockaway Beach, Oregon, valued at \$655,397.53 (April
15 29, 2005) and eight mortgage loans secured by residential condominium properties in Park
16 City, Utah with an assigned value of \$1,968,284.78 (July 1, 2005). Furthermore, the parties
17 agreed to apply as a credit against the amounts then owing under the agreements certain
18 unrelated amounts otherwise owed by Western to Old Standard in the amount of \$563,928.94
19 (August 26, 2005). Consequently, settlements under the agreements since March 10, 2005
20 have aggregated \$3,187,611.25. With respect to the eight mortgage loans conveyed,
21 WESTERN UNITED granted recourse to Old Standard in the event that WESTERN UNITED
22 was able to subsequently dispose of the mortgage loans or underlying collateral for more than
23 the assigned value. Subsequently, WESTERN UNITED disposed at auction the eight loans for
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1 more than the assigned value. WESTERN UNITED estimates that an additional credit in favor
2 of Old Standard of approximately \$800,000 will be applied to amounts owing under the
3 reinsurance agreements when the sales are closed.

4 WESTERN UNITED continues to pursue and consider (a) further agreements with Old
5 Standard involving the transfer of assets in order to satisfy amounts outstanding and (b) a
6 commutation agreement.

7
8 7. *Operating Expenses.* WESTERN UNITED continues its efforts to reduce
9 operating expenses. Since August 2004, employee headcount at WESTERN UNITED has
10 decreased by 52 (from 196 to 144), a reduction of 26.5%. Corresponding with the reduction in
11 staff, since August 2004 the running rate of total annual compensation (salary and benefits) at
12 WESTERN UNITED has decreased from \$11.8 million to \$9.1 million, a reduction of 22.9%.
13 Since the last report, WESTERN UNITED successfully physically merged its Idaho operations
14 with those at its facility in Spokane Valley, Washington. Annual savings from this relocation
15 are estimated to be \$150,000. WESTERN UNITED's actual non-commission expenses for the
16 first two quarters of 2005 were \$19.1 million, which included \$4.9 million of real estate owned
17 holding costs, \$2.5 million of outside legal expenses, and approximately \$1.0 million in
18 accruals for an employee retention program.

19
20 In addition to normal operating expenses, WESTERN UNITED has incurred significant
21 extraordinary expenses arising out of its lawsuit against Ernst & Young LLP and the
22 bankruptcy action involving WESTERN UNITED's indirect parent company, Metropolitan
23 Mortgage & Securities Co., Inc ("Metropolitan"). WESTERN UNITED believes that expenses
24 incurred will be exceeded by the potential for substantial recoveries.
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1 8. *Issues with Parent and Affiliate Companies.* Metropolitan and its sister
2 company, Summit Securities, Inc. ("Summit")(collectively, the "Debtors"), jointly filed for
3 Chapter 11 bankruptcy protection on February 4, 2004. WESTERN UNITED has asserted
4 significant claims against the Debtors. The Debtors dispute most of these claims.
5 Metropolitan has asserted lesser offsetting claims against WESTERN UNITED. WESTERN
6 UNITED believes it has defenses against most of Metropolitan's claims. Negotiations between
7 WESTERN UNITED and the Debtors may resolve the parties' disputed claims.
8

9 On September 26, 2005 the bankruptcy court approved a Disclosure Statement with
10 respect to a plan of reorganization prepared by the Debtors and their respective Creditors'
11 Committees (the "Plan"). WESTERN UNITED believes that the Plan, as filed, results in
12 material adverse tax consequences to the insurance companies owned by the Debtors,
13 including WESTERN UNITED. Objections to the Plan are currently due on November 28,
14 2005. The confirmation hearing for the Plan is currently scheduled for December 13 and 14,
15 2005. There are ongoing discussions about revising the Plan in a manner that will avoid the
16 adverse tax consequences.
17

18 9. *Continued Prospects for Rehabilitation.* On March 25, 2005, Washington
19 Insurance Commissioner Mike Kreidler announced that he and the Insurance Commissioners
20 in Idaho and Arizona (who are overseeing the rehabilitations of Western's sister insurance
21 companies, Old Standard Life Insurance Company of Idaho and Old West Annuity & Life
22 Insurance Company of Arizona) agreed to pursue a consolidated sale of the three insurance
23 companies currently in receivership. Various entities expressed interest in purchasing one or
24 more of the insurance companies and conducted due diligence prior to submitting any offers.
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1 The Washington Office of the Insurance Commissioner is presently involved in discussions
2 with potential purchasers.

3 With respect to the management of a substantial portion of WESTERN UNITED's real
4 estate assets and commercial loan portfolio, WESTERN UNITED anticipates retaining the
5 services of a nationally recognized third-party provider of loan servicing, special servicing and
6 asset resolution services for purposes of improving the management efficiency and financial
7 returns of the nonperforming loan and real estate portfolio.

8 As specified above, WESTERN UNITED has continued to experience a decrease in
9 capital and surplus. However, in addition to engaging in further discussions with potential
10 purchasers, WESTERN UNITED plans to continue selling real property assets which consist
11 of investments as well as collateral for nonperforming loans and reallocating the proceeds in
12 investment vehicles typical of annuity companies, policing commercial loans, reducing
13 operating expenses and carefully monitoring extraordinary expenses with the goal of
14 accomplishing a successful rehabilitation.

15 DATED this 1st day of October, 2005.

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WAYNE C. METCALF, III,
Chief Deputy Receiver for
Western United Life Assurance Company

Presented by:
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CERTIFICATE OF SERVICE OF
THIRD REPORT OF RECEIVER

This will hereby certify that on the 4th day of October, 2005, I mailed a true and correct copy of the Third Report of Receiver in this matter, via the United States Mail, first-class postage prepaid, in sealed envelopes, at Olympia, WA, to the following interested parties:

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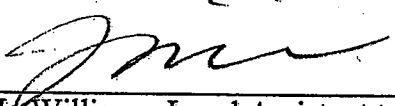
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25 *Chief Deputy Receiver for WULA*

26 DATED this 4th day of October, 2005.


Jo Williams, Legal Assistant to
Christina G. Beusch, Assistant Attorney General